



Edison Electric  
INSTITUTE

*Power by Association™*

January 9, 2020

Mr. Shayne Kuhaneck  
Acting Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

**FASB Agenda Request:  
Lessor Accounting for Sales-type Leases  
with Significant Variable Lease Payments**

Dear Mr. Kuhaneck:

The Edison Electric Institute (EEI) hereby requests the FASB to add a topic to its agenda. EEI is the association that represents all U.S. investor-owned electric companies. Our members provide electricity for 220 million Americans and operate in all 50 states and the District of Columbia. As a whole, the electric power industry supports more than 7 million jobs in communities across the United States. In addition to our U.S. members, EEI has more than 60 international electric companies as International Members, and hundreds of industry suppliers and related organizations as Associate Members. Organized in 1933, EEI provides public policy leadership, strategic business intelligence, and essential conferences and forums.

We request that the FASB consider an agenda topic to address a narrowly focused but increasingly pervasive anomaly under ASC Topic 842, *Leases*, regarding the lessor accounting treatment for sales-type leases with significant variable payments. For sales-type leases with wholly or significant variable lease payments, the application of Topic 842 will result in the recognition of a loss at lease commencement by the lessor for profitable arrangements, and subsequent payments received by the lessor will be recognized as income in their entirety as opposed to being split between lease income and recovery of a lease receivable.

This is a pervasive emerging issue for our industry for arrangements involving renewable generation facilities paired with battery storage systems, which are becoming increasingly common as the technology becomes more scalable and commercially competitive. As explained in more detail below, these reporting outcomes are not

January 9, 2020  
Technical Director  
Financial Accounting Standards Board  
FASB Agenda Request  
Page 2

representationally faithful, either at lease commencement or over the lease term, and fail to provide relevant, useful information to financial statement users.

When such arrangements are determined to contain a lease within the scope of Topic 842, the lease generally would meet its criteria for classification as a sales-type lease. However, Topic 842 does not allow a lessor to include variable payments as part of the consideration in determining the net investment in the lease for sales-type leases. As a result, at lease commencement, the lessor must derecognize the leased asset without recognizing a commensurate lease receivable and instead record a loss.

This aspect of the lessor accounting model results in a significant day-one loss when an economically sound arrangement for the sale of energy from a renewable generation facility that is determined to contain a sales-type lease includes significant variable payment terms. These are profitable arrangements to the project owner-lessor, but derecognizing the leased asset with little to no offsetting net investment in the lease creates a severe disconnect between the accounting and economics of the transaction, both at commencement and over the remaining term of the lease, as the lessor would record most or all payments received as income.

As a result of this anomaly, commercial teams are structuring transactions around the accounting outcomes and sacrificing real economics in order to avoid the day one loss. Additionally, lessors are considering non-GAAP measures to explain the inconsistent financial results, both at lease commencement and over the lease term, increasing the burden on users to determine which measures are most meaningful. Expanded use of non-GAAP measures could also lead to diversity in practice as companies adjust the initial day one loss and the subsequent period lease revenues in different ways.

The Appendix to this letter contains a summary of the background of the issue, evaluation of possible alternatives, and our recommendation of a focused, practical solution to remedy this issue. We believe the approach we suggest would be easy to implement, simplify the accounting model consistent with the Board's overall objectives, and thereby provide representationally faithful information to the users of our members' financial statements. Further, given the narrow focus of this approach, it would not require the reexamination of other aspects of Topic 842, and would lend itself to resolution in a relatively short period of time.

\* \* \* \* \*

January 9, 2020  
Technical Director  
Financial Accounting Standards Board  
FASB Agenda Request  
Page 3

We would be happy to answer any questions as well as share additional perspectives and suggestions with the Board and FASB staff on this agenda request. Please contact Randall Hartman, Director, Accounting, at 202-508-5494 or [rhartman@eei.org](mailto:rhartman@eei.org).

Very truly yours,

/s/ Richard F. McMahon, Jr.

Richard F. McMahon, Jr.  
Vice President, Edison Electric Institute

January 9, 2020  
Technical Director  
Financial Accounting Standards Board  
FASB Agenda Request  
Page 4

## APPENDIX

### Introduction of the Issue:

The application of the lessor accounting model for sales-type leases with significant or wholly variable lease payments under ASC Topic 842 produces financial reporting results that are not representationally faithful. Specifically, the Topic 842 lessor model will result in significant day-one losses when an arrangement for the sale of energy from a renewable generation facility paired with a battery storage system that includes variable payment terms (which is typical) is determined to include a sales-type lease.

The derecognition of the leased asset in these circumstances, with little or no offsetting net investment in the lease, results in recording an artificial loss for profitable transactions and creates a severe disconnect between the accounting and the economic substance of these arrangements, both at commencement and over the term of the lease. This anomalous result is not intuitive to investors, has led to changes in substantive economic terms of arrangements to avoid sales-type lease classification, and is likely to lead to new non-GAAP measures.

This paper illustrates and explains the types of transactions that are of concern to our industry, sets forth the accounting required by Topic 842 and its anomalous results, highlights the relevance of the issue, discusses alternatives for addressing the issue, and proposes a potential solution that better aligns the accounting with the economic substance of these transactions. We encourage the FASB to address this matter through further standard-setting to ensure the accounting model provides useful, representationally faithful information to financial statement users.

### Background:

The electric energy industry is increasingly entering into arrangements for the purchase and sale of energy from renewable (solar and wind) power generation facilities that are in many cases paired with a battery storage system. This trend is expected to accelerate significantly as energy storage becomes more scalable and commercially competitive with traditional generation facilities (e.g., fossil fuel generation). The U.S. electric energy industry is forecasted to invest approximately \$19 billion of capital in battery storage systems attached to renewable facilities over the next 15 years<sup>1</sup>, and

---

<sup>1</sup> Bloomberg NEF 2019 Long-Term Energy Storage Outlook dated July 31, 2019, U.S. "Energy Shifting" Investment, plus 1/3<sup>rd</sup> of U.S. "Peaking Capacity" Investment

January 9, 2020  
Technical Director  
Financial Accounting Standards Board  
FASB Agenda Request  
Page 5

total capital investment in all types of battery storage facilities in the U.S. is expected to exceed \$71 billion over this same period<sup>2</sup>.

Arrangements for the purchase and sale of energy from renewable generation facilities, including facilities paired with battery storage systems, may be determined<sup>3</sup> to contain a lease component. Such arrangements generally result in sales-type lease classification because the lease term typically is for a major part of the economic life of the identified asset.

It is also common for these arrangements to be priced with significant or wholly variable lease payments (e.g., \$50 per MWh of energy generated by the solar generation facility) for the full output produced by the renewable generation facility (i.e., a wholly variable volume of output). The agreements do not typically contain fixed lease payments as the facilities are subject to meteorological uncertainty (e.g., amount of direct sunlight, amount and velocity of wind, etc.) which may not permit electricity production in certain periods.

Customers view the renewable generation from the assets in these arrangements as intermittent on both a daily and hourly basis because it is primarily dependent upon weather. Although the renewable energy generation quantity is weather-dependent over these shorter periods, the owner/lessor formulates an expectation of production at certain degrees of confidence for longer periods, including the multi-year term of such arrangements, utilizing historical information. This expected generation supports the financial analysis of what the return on and return of investment will be at various price points, and these arrangements are priced to be profitable to the project owner.

### **Current Accounting Model and Issue:**

For arrangements with wholly or significant variable lease payments that are determined to be sales-type leases, the application of Topic 842 will result in the recognition of a loss by the lessor at lease commencement. Topic 842 does not allow an entity to include variable payments when computing the investment in the lease. As a result, little to no net investment in the lease is eligible to be recorded at lease commencement, producing a loss for most if not all of the carrying amount of the identified asset when it is derecognized by the lessor.

---

<sup>2</sup> Bloomberg NEF 2019 Long-Term Energy Storage Outlook dated July 31, 2019, U.S. Investment Total

<sup>3</sup> This paper does not address the evaluation of whether the transactions described herein contain a lease. Rather, this paper is focused on the accounting anomaly that results when lessors determine that such arrangements contain a lease that meets the requirements of Topic 842 for classification as a sales-type lease.

January 9, 2020  
Technical Director  
Financial Accounting Standards Board  
FASB Agenda Request  
Page 6

Stakeholders are concerned about recognizing a loss at commencement in these arrangements because doing so does not faithfully represent the economics of the lessor's transaction with the lessee. These are not loss contracts, and a lessor would not enter into an arrangement that produces an immediate economic loss on the effective "sale" of its asset. Rather, the lessor has priced the arrangement to receive an appropriate positive return on and return of its investment using an expected payment stream that is based on usage or performance.

However, the requirements of the lessor accounting model prohibit the lessor from including any variable payment streams in the calculation of what is, effectively, its transaction price. As such, the recognition of a loss in these circumstances is solely a result of an anomaly in the lessor accounting model and does not properly reflect the economics of the transaction. As a consequential outcome, lease income over the term of the arrangement will be substantially higher than if the lessor had recorded a lease receivable, which would be recovered by the lessee's payments for use of the asset.

For example, one EEI member company recently placed into service a renewable generation facility paired with a battery storage system and contracted with a customer to sell all of the electrical output of the facility at a specified price per MWh generated. The arrangement was determined to contain a lease and was classified as a sales-type lease. Because the arrangement contained entirely variable lease payments (i.e., no fixed payments), the company was required to record a day one loss equal to the carrying value of the battery storage system, resulting in a more than insignificant impact to earnings per share. Following lease commencement, the company is recognizing the full amount of lease payments as income, though economically a majority of the lease income recognized is effectively the recovery of the previous day-one loss recorded for accounting purposes.

Instances of material day one losses followed by significant lease income will become increasingly common as the industry continues its expansion into these types of arrangements. Member companies are considering new non-GAAP measures in order to explain to investors the disconnect between the accounting and economics of these transactions.

As an alternative to the inherently more subjective nature of using non-GAAP measures to explain material transactions, some commercial teams are working to structure around sales-type lease accounting for these types of arrangements in order to avoid a commencement loss. However, project owners must be willing to accept variable payment terms in order to win bids from customers. When structuring around sales-type

January 9, 2020  
Technical Director  
Financial Accounting Standards Board  
FASB Agenda Request  
Page 7

lease accounting, commercial teams of both parties may be forced to surrender certain commercially substantive contractual rights in order to avoid the impact of sales-type lease accounting. This has significantly increased the complexity of doing business and increased the time and expense to close on a transaction. Furthermore, this places U.S. power producers at a commercial disadvantage to foreign competitors who apply IFRS, which considers variable payments in the lease classification, generally resulting in an operating lease and avoiding day one losses.

### **Potential Solutions:**

EI has evaluated the following alternatives for addressing this issue. We believe both of the alternatives described below would address our concern and would lead to greater alignment between the substance of these transactions and the accounting.

#### ***Alternative 1: Apply the Topic 606 variable consideration guidance***

Amend Topic 842 to allow lessors to include variable lease payments in the measurement of their net investment in sales-type leases with wholly or significant variable lease payments through reference to the existing Topic 606 variable consideration measurement model.

### **Pros**

Through the redeliberations leading to the issuance of the final ASU, many FASB members expressed that, in their view, sales-type leases were fundamentally just financed sales to a customer. Many of the Board's lessor accounting model decisions reflect that view. For example, the lessor accounting guidance about collectibility issues arising in sales-type leases was developed so that entities would address such issues in the same manner as if the lessor sold the asset in an outright sale<sup>4</sup>. Similarly, the accounting for initial direct costs<sup>5</sup> and modifications of contracts that include leases was developed to more closely align lessor accounting for leases (all leases, not just sales-type leases) with vendor revenue recognition accounting under Topic 606.

Assuming it was the Board's intent to align lessor accounting, particularly for sales-type leases, with the accounting by vendors for revenue transactions, the Board could amend the guidance to allow lessors to include variable lease payments in the measurement of their net investment in leases through reference to the Topic 606 variable consideration measurement model. This solution would both (a) resolve the

---

<sup>4</sup> For example, ASU No. 2016-02 paragraphs BC92 and BC104.

<sup>5</sup> For example, ASU No. 2016-02 paragraphs BC306-BC307.

January 9, 2020  
Technical Director  
Financial Accounting Standards Board  
FASB Agenda Request  
Page 8

“day one loss” issue and (b) achieve more cohesion between sales-type lease accounting and outright sale accounting performed in accordance with Topic 606, which appeared to be a consideration of the Board in developing Topic 842.

## **Cons**

Although this alternative has some merit with respect to the alignment of sales-type leases and outright sale accounting, it is conceptually contrary to the FASB’s fundamental decision in its lengthy deliberations on Topic 842 to exclude variable payments from the measurement of lease assets and liabilities for both lessees and lessors. While this shortcoming would be mitigated to some extent by applying it only to lessor sales-type lease fact patterns that involve significant or wholly variable payments, nonetheless it would introduce an inconsistency with the accounting by lessors and lessees for substantially all other leases under Topic 842 unless the standard’s entire model were revisited, which does not seem appropriate or warranted. Such an inconsistency arguably would reduce the usefulness to financial statement users (and certainly the comparability) of lease assets and liabilities reported on the balance sheet; it also likely would require additional disclosures.

This alternative also would be quite complex. If aligned with Topic 606 principles, it would require the ongoing estimation, measurement, and computation of the effects of variable lease payments similar to the variable consideration model of Topic 606. Estimating and constraining variable lease payments over contract terms of 20-30 years would introduce constantly varying measurement of the lease, require significant judgment, and provide less useful information consistent with the fundamental economics of the arrangements. Additionally, we observe in Topic 606 that the Board decided against immediate revenue recognition when similar uncertainties exist, and judgments are required for a royalty arrangement of an intellectual property license. Instead, the Board concluded that recognition should occur as sales or usage occurs.

### ***Alternative 2: Revise Topic 842 to require lessors to classify such leases as operating leases***

Amend Topic 842 to incorporate the following incremental guidance for lease classification to remedy the issue of day-one losses on sales-type leases as described herein:

**842-10-25-3A** *The criteria in paragraphs 842-10-25-2 and 25-3 notwithstanding, a lease for which the majority of payments for the right to use the underlying asset are variable shall be classified by a lessor as an operating lease.*

January 9, 2020  
Technical Director  
Financial Accounting Standards Board  
FASB Agenda Request  
Page 9

## **Pros**

This alternative is a pragmatic solution that addresses the lack of representational faithfulness resulting from day-one losses and the derecognition of valuable, owned property, plant and equipment on sales-type leases. It is intuitive in that it more faithfully reports the underlying economics of such arrangements than the current guidance by eliminating the recording of a day-one loss and derecognizing the lessor's owned asset. Further, it would preserve rather than modify the underlying fundamental decision in Topic 842 generally to exclude variable payments in the measurement of lease assets and liabilities.

This alternative also avoids two of the major detriments of Alternative 1. First, it would be much simpler to implement in that it would not require the ongoing estimation, measurement, and computation of the effects of variable lease payments similar to the variable consideration model of Topic 606. Second, because it would be narrow in its application and address only the initial classification of a subset of arrangements (those that are impacted significantly by this measurement anomaly), it would minimize the extent of revisions to Topic 842 as compared to a broader requirement to include variable payments as described in Alternative 1. Once the classification is determined under Alternative 2, the arrangement would be accounted for in a manner consistent with the existing requirements of Topic 842 for that classification; no changes to other aspects of Topic 842 would be necessary.

January 9, 2020  
Technical Director  
Financial Accounting Standards Board  
FASB Agenda Request  
Page 10

Although not an objective for adopting this approach, this alternative would have the added benefit of greater convergence with IFRS 16<sup>6</sup> than the current model for such leases. EEI members compete with companies in the renewable energy sector that report under IFRS, and this approach would eliminate competitive arbitrage due to accounting differences.

### **Cons**

The principal drawback to this alternative is that it introduces an exception to the existing guidance in Topic 842 for impacted leases.

### ***Recommendation***

The accounting anomaly described herein should be addressed in order to assure that users of lessor financial statements have access to representationally faithful financial information. Accounting for such transactions under the existing guidance in Topic 842 produces both balance sheets and results of operations that fail to reflect the underlying economics of these increasingly common transactions.

While both alternatives above would address this accounting anomaly, we recommend the adoption of Alternative 2. Alternative 2 is simpler, more cost-effective, more operationally efficient, and achieves the objective of materially improved financial reporting. It is limited in its scope and implications for other aspects of Topic 842 and avoids the introduction of a more complex model that would be inconsistent with previous underlying decisions on lease measurement.

The resulting application of operating lease provisions would simplify the accounting for such leases at commencement and over the term of the lease, align reported financial results with the underlying economics, provide users financial information that is understandable and substantially more representationally faithful, avoid the need for preparers to consider non-GAAP adjustments that may not be applied consistently, and eliminate commercial structuring motivation.

---

<sup>6</sup> IFRS 16.65 provides for operating lease classification in certain circumstances when there are variable lease payments: “The examples and indicators in paragraphs 63–64 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset, the lease is classified as an operating lease. For example, this may be the case if ownership of the underlying asset transfers at the end of the lease for a variable payment equal to its then fair value, or if there are variable lease payments, as a result of which the lessor does not transfer substantially all such risks and rewards.”

This alternative would result in convergence on classification for the subset of lease arrangements to which it applies.

January 9, 2020  
Technical Director  
Financial Accounting Standards Board  
FASB Agenda Request  
Page 11

Beyond providing financial information that is more representationally faithful, this alternative has the added benefit of achieving a more converged accounting solution by treating the impacted arrangements as operating leases consistent with how we understand these arrangements are generally accounted for under IFRS 16.